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June 24, 2004

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Verizon Telephone Companies Petition For Reconsideration, "In the Matter of Stale or Moot Docketed Proceedings", CC Docket Nos. 93-193, 94-65 and 94-157

Dear Ms. Dortch:

The attached document was sent by e-mail on June 24, 2004, to Christopher Libertelli (Legal Advisor to Chairman Powell), Daniel Gonzalez (Legal Advisor to Commissioner Martin), Jessica Rosenworcel (Legal Advisor to Commissioner Copps), Scott Bergmann (Legal Advisor to Commissioner Adelstein), and William Maher, Tamara Preiss, and Deena Shetler of the Wireline Competition Bureau. The document provides Verizon's response to a June 2, 2004 AT&T ex parte filed in the above captioned proceeding.

Please do not hesitate to contact me with any questions.

Sincerely,

/s/Joseph Mulieri

Attachment

cc: S. Bergmann
D. Gonzalez
C. Libertelli
W. Maher
T. Preiss
J. Rosenworcel
D. Shetler

VERIZON'S TARIFF FILINGS WERE CONSISTENT WITH FCC RULES — AT&T'S JUNE 2, 2004 DOES NOT SUPPORT A DIFFERENT VIEW

The 24 pages of bullet points in AT&T's June 2, 2004 ex parte repeat nearly every argument AT&T has ever raised during the lengthy course of this proceeding. Verizon has already demonstrated that, contrary to AT&T's claims, the Verizon tariffs at issue were lawful and that, in any event, that the Commission either cannot or should not require refunds if it determines that Verizon's tariffs were unlawful. Verizon here responds to the few new claims AT&T has raised, and corrects the most egregious of AT&T's misstatements of the factual record and applicable legal standards.

- **RAO 20**

  - The Commission has already conclusively held that its rules in effect prior to 1997 *did not* permit deduction of OPEBs from the interstate rate base for purposes of calculating a LEC's sharing obligation.

    - Indeed, AT&T itself recognized as much in 1996 when it argued that the Commission should "act expeditiously to amend its rules prospectively" to require deduction of OPEBs because "[u]ntil such time as the Commission recasts the Part 65 rules as proposed in the *NPRM*, carriers' rate base amounts will continue to be overstated." AT&T Comments at 5, CC Docket No. 96-22 (Apr. 12, 1996).

    - That is, AT&T argued that, *until* the Commission *amended* its rules, OPEBs would not be deducted from LECs' interstate rate base.

  - As Verizon has shown, the Commission — which amended its rules prospectively in 1997 to require deduction of OPEBs — cannot modify those rules retroactively through a tariff investigation.

    - In tariff investigations, the Commission "merely applies the obligations imposed by the statute or previously adopted Commission rules to particular carrier conduct." 5 FCC Rcd 4861, ¶¶ 7-8.

    - Tariff investigations determine "compliance with our access charge rules," while "[p]roposals to change or reconsider those rules should be submitted in a new rulemaking petition." 101 F.C.C.2d 911, ¶ 17 n.23.

    - Nothing AT&T cites is to the contrary. Indeed, in the *Access Tariff Reform Order*, which AT&T cites (Ex Parte, RAO 20 at 5), the Commission held only that where it "has ordered LECs to make certain exogenous cost changes in a rulemaking proceeding" but did "not adopt a specific methodology" for calculating the exogenous cost change, "it can specif[y] the methodology for making those changes in a subsequent tariff investigation." 13 FCC Rcd 14683, ¶¶ 71, 81.

      - But that is not the case here, as the Commission has already held that its rules "define explicitly" how to calculate the interstate rate base, 11 FCC Rcd 2957, ¶ 25, and do not permit deduction of OPEBs, 12 FCC Rcd 2321, ¶ 28 ("[g]iving rate base recognition to OPEB in Part 65 would constitute a *rule change*") (emphasis added).

- Nor is the RAO 20 investigation like the Add-Back investigation discussed below. There, in amending its rules in 1995 prospectively to require add-back, the Commission noted that it was "not decid[ing]" whether add-back "is required for purposes of the 1993 and 1994 Annual Access Tariff Filings," which are "under examination as part of [the] investigation of the 1993 and 1994 Annual Access Tariff Filings." 10 FCC Rcd 5656, ¶ 4 n.3.

    - As an initial matter, the Commission's decision, in a rulemaking, to refrain from prejudging an issue in a pending tariff investigation is unremarkable, especially when add-back was only one of many issues raised in that investigation.

    - Moreover, while the Commission's rules "defined explicitly" how to calculate the rate base for sharing purposes, it "ha[d] *never been clear*" whether the Commission's rules required add-back. *Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1207 (D.C. Cir. 1996) (emphasis added).

- Although the Commission's orders vacating RAO 20 and denying MCI's petition for reconsideration mentioned "pending [tariff] investigations," those were *not* the investigation of LECs' 1996 tariff filings implementing the Commission's vacatur of RAO 20. 12 FCC Rcd 2321, ¶ 21; *see* 11 FCC Rcd 2957, ¶ 28. The 1996 tariffs were filed *after* the order vacating RAO 20 was issued.

    - Instead, the investigations referenced were into the LECs' 1993-1995 tariff filings, in which they sought "exogenous treatment of OPEB amounts." 12 FCC Rcd 2321, ¶ 21. The Commission rejected claims that amending § 65.830 would be "premature until there is a resolution of the underlying question of whether OPEB costs will be treated as exogenous." 11 FCC Rcd 2957, ¶ 23.

    - AT&T opposed delay, arguing that, because the "Part 65 rule changes would affect the composition of the rate base on a *going forward* basis," the "new rule would not impact the Commission's pending OPEB exogenous cost investigation, which deals with past OPEB expenses." AT&T Comments at 4, CC Docket No. 96-22 (Apr. 12, 1996).

- The Commission's rules in effect prior to 1997 stated that:

    - The "rate base *shall* consist of the interstate portion of the accounts listed in § 65.820 . . . , minus any deducted items computed *in accordance with* § 65.830," which in turn listed the items that "*shall* be deducted from the interstate rate base," including the "interstate portion of unfunded accrued pension costs (Account 4310)" but not OPEBs. 47 C.F.R. §§ 65.800, 65.830(a)(3).

        - As AT&T itself recognizes, "shall" is a mandatory term. *See* AT&T Ex Parte, RAO 20 at 3; *Association of Am. R.R. v. Costly*, 562 F.2d 1310, 1312 (D.C. Cir. 1977) ("'shall' is the language of command").

        - And the Commission has held that these sections "define explicitly those items to be included in, or excluded from, the interstate rate base." 11 FCC Rcd 2957, ¶ 25.

- Contrary to AT&T's claim, a 1995 Commission ruling on an Ameritech tariff did not add a new requirement to § 65.820. *See* AT&T Ex Parte, RAO 20 at 5 & n.1. Instead, as Verizon has shown, LECs understood that § 65.820, as promulgated in 1987, already "exclu[ded] . . . non-cash items," such as "the cost of common stock equity," from cash working capital. 4 FCC Rcd 1697, ¶ 24.

    - In the 1995 order AT&T cites, the Commission simply rejected Ameritech's claim that the exclusion of equity was first established in 1989. 10 FCC Rcd 5606, App. A, ¶ 6.

    - It is of no help to AT&T that the Commission *also* held that Ameritech's interpretation of the 1987 rule was unreasonable in any event. *See id.* ("even if" 1987 rules did not "specifically exclude equity," those rules "cannot logically or legally be relied upon to justify including equity in [pre-1989] calculations"). As shown below, the Commission has already held that Verizon's interpretation of the pre-1997 rules is correct.

- In 1997, in the same order in which it adopted a *new rule* requiring deduction of OPEBs, the Commission rejected MCI's claim that the *old rules* could be interpreted to require LECs to deduct OPEBs, explaining that "[g]iving rate base recognition to OPEB in Part 65 would constitute a rule change." 12 FCC Rcd 2321, ¶ 28.

    - This is consistent with the Commission's 1996 determination that the RAO 20 letter exceeded the Bureau's authority because it "directed [an] exclusion[] from . . . the rate base for which the Part 65 rules do not specifically provide." 11 FCC Rcd 2957, ¶ 25.

    - AT&T is thus wrong in claiming that the Commission lawfully could have issued RAO 20. *See* AT&T Ex Parte, RAO 20 at 9. The Commission's holding that deduction of OPEBs could not be required "through an interpretation" of the old rules applies equally to the Commission and its Bureaus. 12 FCC Rcd 2321, ¶ 28.

        - It is irrelevant that the Commission might have amended its rules sooner but for the unlawful RAO 20 (AT&T Ex Parte, RAO 20 at 9), because the Commission is "bound to follow [existing rules] until such time as it altered them through another rulemaking." *Southwestern Bell Tel. Co. v. FCC*, 28 F.3d 165, 169 (D.C. Cir. 1994).

    - AT&T is also wrong that a "[l]ong-standing Commission policy" required exclusion of all zero-cost sources of funds and that "categories expressly listed in section 65.830 at any given time thus merely reflect the [zero-cost sources of funds] that have come to the Commission's attention." AT&T Ex Part, RAO 20 at 1, 4, 5 n.1.

        - In fact, in 1987, the Commission considered *but expressly rejected* a rule that would have required deduction of all zero-cost sources of funds and, instead, adopted a rule that distinguished between pensions (must be deducted) and other long-term liabilities (not to be deducted). *Compare* 2 FCC Rcd 332, App. A (1986) (proposed 47 C.F.R. §§ 65.810(b), 65.830) *with* 3 FCC Rcd 269, App. B (1987).

- The current rule is not limited to pensions and OPEBs, but instead — and unlike the prior rule — generally requires deduction of "other long-term liabilities" in "Account 4310." 47 C.F.R. § 65.830(a)(3). The Commission could have adopted that same rule in 1987, as the definition of Account 4310 has not changed, but it did not.

- Even if the Commission also would have excluded OPEBs in 1987 if pensions and OPEBs were subject to the same accounting treatment at that time, that is irrelevant to the proper interpretation of the rules that it did adopt. *See Grider v. Cavazos*, 911 F.2d 1158 (5th Cir. 1990) (although "the drafters of the Regulation" might have "made special provisions" for certain loans, if they had been aware of them, "[i]t suffices . . . that the drafters of the Regulation did not do so").

- Because the Commission's rules in effect in 1996 did not permit deduction of OPEBs from the rate base for purposes of calculating the sharing obligation, the Commission has no authority under § 201 to find that LECs acted unlawfully by following the Commission's rules. *See*, *e.g.*, 6 FCC Rcd 2637, ¶¶ 153 n.211, 202.

  - Although AT&T disputes this, the Commission decisions it cites hold only that "compliance with the price cap rules does not make [it] impossible" that "*rates for specific services* may be set at unreasonable levels, or unlawful in other ways." *Id.* ¶ 206 (emphasis added), *quoted in* AT&T Ex Parte, RAO 20 at 7.

  - But AT&T is not challenging the "rate" for any "specific service" — it is challenging the manner in which Verizon and other LECs calculated their price cap indices and, thus, claiming that rates are too high *overall*. But this is precisely the type of challenge that the Commission has held is "foreclosed by price cap regulation" where a LEC "is correctly administering the sharing requirements." 6 FCC Rcd 2637, ¶¶ 153 n.211, 206.

  - Moreover, as the precedents on which AT&T relies demonstrate, the possibility that a specific rate is unlawful despite compliance with the price cap rules exists only where, unlike here, those rules do not "define explicitly" how carriers must calculate their rates. 11 FCC Rcd 2957, ¶ 25 (rules "define explicitly those items to be included in, or excluded from, the interstate rate base").

- Verizon's revision of its 1993 and 1994 interstate rate of return report, to undo the effect of RAO 20, was consistent with the Commission's rules. (Verizon's 1995 interstate rate of return was calculated for the first time when Verizon filed its 1996 tariff, and was calculated in accordance with the Commission's vacatur of RAO 20.)

  - Under the Commission's rules in effect in 1996, Verizon was required to file revised reports setting forth its interstate rate of return and "reflecting any corrections or modifications to the report [previously] filed." 47 C.F.R. § 65.600(d)(2) ("Each [LEC] . . . *shall* file . . . within fifteen (15) months after the end of each calendar year a report reflecting any corrections or modifications"). This rule, therefore mandated revisions to Verizon's calculation of its 1994 interstate rate of return (and associated

sharing requirement), which had been calculated in accordance with the vacated RAO 20.

- Those rules also did not prohibit Verizon from revising its 1993 interstate rate of return more than 15 months after the end of the 1993 calendar year. Corrections to the 1993 interstate rate of return (and associated sharing requirement) were warranted in light of the Commission's four-year delay in ruling on requests for review of RAO 20.

- Contrary to AT&T's claim, nothing in Part 61 prevented Verizon from making a sharing adjustment in its 1996 tariff filings based on either the newly calculated rate of return for 1995 or the corrected interstate rates of return for 1993 and 1994. *See* AT&T Ex Parte, RAO 20 at 3-4.

    - In fact, § 61.45(d)(2) required Verizon to make an exogenous adjustment to its price caps to reflect "any sharing of base period earnings required by the sharing mechanism."

        - AT&T claims that the reference to the "base period" limits Verizon to calculating the sharing adjustment based only on the 1995 interstate rate of return. *See* AT&T Ex Parte, RAO 20 at 3. (AT&T incorrectly describes that 1995 calculation as a "reversal of the OPEB deduction." *Id.* As explained above, Verizon had not previously calculated its sharing obligation based on its 1995 interstate rate of return. Therefore, there was nothing to reverse.)

        - But the fact that "base period earnings" are what is being shared does not limit the scope of the exogenous adjustment required to account for the then-existing sharing obligation. Instead, § 61.45(d)(2) mandates an adjustment as "required by the sharing mechanism" set forth in Part 65. As shown above, Verizon's adjustment to undo the effect of the unlawful RAO 20 complied with the sharing mechanism.

    - AT&T is also wrong in claiming that Verizon's 1996 tariffs did not comply with the rule adopted in 1995 preventing LECs from making exogenous cost adjustments for OPEBs. *See* AT&T Ex Parte, RAO 20 at 4. Verizon did not make an exogenous adjustment for OPEB costs in its 1996 tariffs — instead, it made an exogenous adjustment to reflect its sharing obligation, as properly calculated under the rules in effect prior to 1997. In calculating its sharing obligation, Verizon did not deduct OPEBs from the rate base used to calculate the sharing obligation (as required by the rules), but that is far different from seeking an independent exogenous cost increase *because of* OPEB costs.

    - Because there is no conflict between the Part 61 and Part 65 rules, there is no ambiguity for the Commission to resolve, as AT&T claims (Ex Parte, RAO 20 at 6).

- It would be profoundly inequitable for the Commission to require refunds based on a finding, eight years after the fact, that Verizon acted unlawfully by following the clear instructions with respect to the deduction of OPEBs from the rate base that the Commission had provided just months before Verizon's 1996 tariff filing.

- Contrary to the implication AT&T seeks to leave (Ex Parte, RAO 20 at 9), the law is clear that refunds are "a matter of equity," and the Commission must "balance the interests of both the carrier and the customer in determining the public interest," with "each case . . . examined in light of its own particular circumstances." 67 F.C.C.2d 703, ¶ 15; *see Public Service Comm'n v. Economic Regulatory Admin.*, 777 F.2d 31, 36 & n.5 (D.C. Cir. 1985); *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981).

    - Moreover, AT&T's claim that requiring refunds would "put the Bells in the same position they would have occupied but for the issuance of the *RAO 20 Letter*" is wrong. AT&T Ex Parte, RAO 20 at 9. As shown above, the rules in effect prior to 1997 did not, and could not be interpreted to, permit (let alone require) deduction of OPEBs. AT&T's claim that the Commission would have amended its rules sooner but for the Bureau's unlawful interpretation of those rules is pure speculation — as evidenced by the four years it took the Commission to rule on petitions for review of the Bureau's decision.

- Tellingly, AT&T does not deny that it recovered additional costs *from its customers* based on Verizon's and other LECs' treatment of OPEBs in their 1996 tariffs. Nor does AT&T suggest — let alone commit — that it would pass through any refunds to the consumers that it overcharged. In fact, because such refunds would be virtually impossible in any event — many of AT&T's former customers have shifted to long-distance calling options that did not exist in 1996 — AT&T (like the other IXCs that would benefit from an order requiring refunds) would simply pocket the money and, therefore, would be unjustly enriched.

- Relying on the *Pay Telephone Reclassification Order*, 17 FCC Rcd 21274 (2002),[1] AT&T claims that the Commission has rejected the argument that it would be inequitable for carriers to receive refunds when they had passed through to their customers any overcharges. *See* AT&T Ex Parte, RAO 20 at 10.

    - But as the Commission stressed in that order, the D.C. Circuit, in a decision remanding a rate the Commission had prescribed, "plainly expected the Commission to order a refund." 17 FCC Rcd 21274, ¶ 77 (citing *MCI Telecomms. Corp. v. FCC*, 143 F.3d 606 (D.C. Cir. 1998)). The Commission then held that, "[r]egardless of the extent of pass-throughs [of overcharges] to consumers," "all of the carriers were reasonably entitled to rely on the *MCI* opinion to form a legitimate expectation that they would receive refunds." *Id.* ¶ 80.

    - AT&T and the other IXCs had no comparable basis for an expectation of refunds here, especially when the Commission expressly rejected MCI's claim that the

[1] Although AT&T quotes the *Pay Telephone Classification Order*, it cites *Communications Vending*, 17 FCC Rcd 24201. *See* AT&T Ex Parte, RAO 20 at 10. In that case, the Commission rejected the defendant's claim that refunds would be inappropriate because if it had not overcharged the independent payphone providers it would have imposed higher charges on interexchange carriers. 17 FCC Rcd 24201, ¶ 47. This ruling, obviously, has no application here.

Commission's pre-1997 rules could be interpreted to require deduction of OPEBs from the interstate rate base.

- **Add-Back**

  - Prior to the Commission's 1995 decision to adopt an "explicit add-back rule . . . on a *prospective* basis," 10 FCC Rcd 5656, ¶ 49 (emphasis added), the "state of the law [on whether add-back is required under price caps] *has never been clear*, and the issue has been disputed since it first arose in 1993," *Bell Atlantic*, 79 F.3d at 1207 (emphasis added).

    - That is, the D.C. Circuit held that there had been "considerable uncertainty" about whether add-back was required. *Id.* That court did not, as AT&T claims, "recognize[] that add-back was always an implicit part of the price cap rules." AT&T Ex Parte, Add-Back at 2.

    - And the Commission itself recognized that add-back "was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules." 10 FCC Rcd 5656, ¶ 15 (internal quotation marks omitted).

  - In the face of this uncertainty, each LEC made its own determination of whether add-back was required and applied that determination consistently, regardless of whether sharing or the lower formula adjustment applied.

    - NYNEX applied add-back in 1993 after it made a lower formula adjustment and continued to apply add-back in 1994 when it incurred sharing obligations.

    - GTE did not apply add-back in 1993 or 1994 for any of its local exchange carriers, even though some had made lower formula adjustments and others incurred sharing obligations in those years. Indeed, GTE would have been able to *raise its rates* if it had applied add-back during those years.

    - Thus, there is no basis to AT&T's assertion that LECs "appl[ied] add-back only when it increased rates." AT&T Ex Parte, Add-Back at 6.

    - Nor is AT&T correct that LECs, at the time, argued that it would be improper for each LEC to make its own, consistently applied, determination as to whether add-back was required. *See id.*

      - In fact, what AT&T quotes are the LECs' objections to an *MCI* proposal that would have required add-back when LECs had a sharing obligation, but prohibited add-back if the lower formula adjustment applied. *See*, *e.g.*, Reply Comments of Bell Atlantic Telephone Companies, CC Docket No. 93-179, at 4 (FCC filed Sept. 1, 1993).

      - At the same time the LECs opposed MCI's one-sided proposal, they were applying (or not applying) add-back consistently — regardless of whether sharing or the lower-formula adjustment applied

- The Commission cannot find — some 10 years later — that the LECs' response to the uncertainty about whether add-back would be required was unreasonable.

  - Even if it did, that uncertainty would preclude the Commission from requiring refunds.

    - Indeed, in promulgating its add-back rule in 1995, the Commission expressly stated that it "agree[d] with [the LECs] that the explicit add-back rule adopted here may, as a legal matter, be applied *only on a prospective basis*." 10 FCC Rcd 5656, ¶ 49 & nn.63, 65 (emphasis added) (citing *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988)).

    - That the Commission did not, at that time, also "decide . . . whether an add-back adjustment is required for purposes of the 1993 and 1994 Annual Access Tariff Filings," *id.* ¶ 4 n.3, does nothing to change the fact that a decision requiring add-back would be impermissibly retroactive.

  - As the D.C. Circuit has recognized, a LEC's choice of X-factor in its 1993 and 1994 tariff filings was based on its understanding of whether add-back was required. *Bell Atlantic*, 79 F.3d at 1207.

    - Bell Atlantic, for example, selected the lower X-factor in its 1993 and 1994 tariff filings, when it did not apply add-back, and selected the higher X-factor for its 1995 and 1996 tariff filings, after the Commission made add-back mandatory.

  - Because the Commission cannot, at this point, undo the effects of the X-factor selection, an order requiring refunds based on a LEC's decision to use (or not use) add-back would impermissibly deprive those carriers of "the benefit of th[eir] decision" as to the X-factor to select. *Id.*

    - Indeed, in upholding the Commission's 1995 order requiring use of add-back prospectively, the D.C. Circuit stressed that LECs "have already received the benefit of th[e] [X-factor] decision" in "previous years" — that is, in 1993 and 1994. *Id.*; *see also id.* (giving add-back rule "only future effect" "does not change or invalidate any current tariffs").

  - In arguing that the Commission has authority to require add-back retroactively, AT&T ignores that the limited exception that § 204 provides to the rule against retroactive *ratemaking* does not authorize the Commission to engage in retroactive *rulemaking*. *See* AT&T Ex Parte, Add-Back at 5.

    - AT&T also ignores the D.C. Circuit's conclusion that "the Commission properly decided to implement the [add-back] rule *prospectively*." 79 F.3d at 1208 (emphasis added).

- **Exogenous Cost Treatment of OPEBs**

  - OPEB costs incurred prior to December 15, 1992 were eligible for exogenous cost treatment under the Commission rules in effect.

- Bell Atlantic notified the Commission on December 31, 1991 of its intent to adopt SFAS 106, which FASB approved in December 1990 and which required accounting of OPEB costs on an accrual basis.

    - Under the Commission's rules, accounting changes, once approved by FASB, "automatically *take effect* 90 days after the company informs this Commission of its intention to follow the new standard, unless the Commission notifies the company to the contrary." 47 C.F.R. § 32.16(a) (1996) (emphasis added).

        - On December 26, 1991, the Common Carrier Bureau had determined, in response to similar notifications by Southwestern Bell and GTE, that all carriers should implement SFAS 106 "on or before January 1, 1993," noting that FASB stated that "earlier implementation is encouraged." 6 FCC Rcd 7560, ¶¶ 2-3.

    - AT&T is thus wrong in claiming that SFAS 106 did not become effective until December 15, 1992, the date FASB selected for SFAS 106 to become mandatory. *See* AT&T Ex Parte, OPEB at 2. Under the Commission's rules, SFAS 106 "automatically t[ook] effect" 90 days after Verizon notified the Commission of its intent to follow SFAS 106.

        - AT&T is also wrong in relying on the Bureau's rejection of AT&T's own effort to adopt SFAS 106 months *before* FASB approved it. *See id.*

        - As the Bureau explained, "[n]either the language of the rule, [n]or the language of the Price Cap Order, enable AT & T to claim as exogenous a *proposed* change in GAAP." 5 FCC Rcd 3680, ¶ 4 (emphasis added).

        - Verizon, in contrast, followed SFAS 106 *after* it was approved by FASB and *after* it took effect under the Commission's rules.

- The costs incurred prior to December 15, 1992, as a result of SFAS 106 satisfy the Commission's "control" test for exogenous treatment.

    - As the D.C. Circuit held, "the 'control' test [is] satisfied simply by the fact of exogenous imposition of the accounting rule." *Southwestern Bell*, 28 F.3d at 170.

    - The court held, moreover, that "there is not a hint" in the Commission's control test of a requirement that carriers not "exercise substantial control over the . . . timing of OPEB expenses," and also that the Commission could not modify its control test, except through a notice-and-comment rulemaking. *Id.* at 169 (internal quotation marks omitted).

    - Indeed, although the Commission initially held that Verizon's and other LECs' 1992 tariffs unlawfully sought exogenous treatment of the costs associated with this accounting change — a decision the D.C. Circuit later reversed (28 F.3d 165) — neither the Commission nor any party claimed that the *timing* of Verizon's implementation of SFAS 106 meant that these costs did not qualify for exogenous cost treatment.

- On the contrary, AT&T argued that LECs were entitled to exogenous cost treatment of at least part of the OPEB costs they accrued prior to December 15, 1992. *See* 8 FCC Rcd 1024, ¶¶ 30-31.

- AT&T's current argument — that LECs' ability to adopt SFAS 106 before it became mandatory means that the accounting change was not beyond their control — is contrary both to its argument at the time and to the D.C. Circuit's determination that "exogenous imposition of the accounting rule" is sufficient to satisfy the control test. *See* AT&T Ex Parte, OPEB at 2-3.

- In any event, because the Commission encouraged carriers to adopt SFAS 106 before the January 1, 1993, deadline, it would be arbitrary and capricious for it to disallow exogenous treatment of costs incurred by carriers that followed the Commission's suggestion.

  - And, as AT&T itself has acknowledged, there are "ratepayer savings associated with early accrual" of OPEB costs. 5 FCC Rcd 3680, ¶ 3.

- **Headroom**

  - The Commission's authority to order refunds in a proceeding to investigate a tariff is limited to "such amounts [as] were paid" that were not lawful. 47 U.S.C. § 204(a); *see AT&T Co. v. FCC*, 836 F.2d 1386, 1394 (D.C. Cir. 1988)

    - Under price cap regulation, a carrier's rates, as measured by the actual price indices ("APIs"), could be lower than its price cap indices ("PCIs"), creating "headroom," which is the amount by which a carrier's APIs were lower than its PCIs.

      - As the Commission has explained, headroom "represents charges that could have been, *but were not*, collected from customers." 12 FCC Rcd 8396, ¶ 11 (emphasis added).

      - For this reason, the Commission has held that any lawful refund is limited to the amount by "which [a LEC's] API exceeded the PCI, as adjusted, as required by the Commission" — that is, after any exogenous costs that are disallowed by the Commission are removed from the PCI. *Id.*

    - Indeed, AT&T concedes that any refund obligation the Commission might impose must be offset against the available headroom in each price cap basket. *See* AT&T Ex Parte, OPEB at 4.

    - And Verizon has "headroom" available with respect to each of the tariff investigations at issue here.

  - In its June 2, 2004 ex parte, AT&T takes issue only with Verizon's calculation of the headroom in one basket in Bell Atlantic's 1993 tariff filing.

    - But Verizon and AT&T are largely in agreement about how much headroom exists in that tariff and about the appropriate method for calculating headroom.

- Indeed, except as to that one basket, Verizon and AT&T agree on the available headroom — with the result that AT&T has been required to reduce dramatically the amount it claims Verizon would owe if the Commission disallowed Verizon's exogenous cost treatment of OPEBs, from $40.6 million to only $7.4 million. *See id.* at 5.

- As Verizon has explained, however, AT&T has erroneously calculated the headroom in the Special Access/Trunking basket for Verizon's 1993 tariff filing. Under a proper calculation, the largest refund that could be required is slightly more than $2 million.

    - In 1992, as part of the Local Transport Restructure, the Commission made the Special Access basket part of the newly created Trunking basket. LECs were required to file tariffs incorporating the rate structures for transport by August 2, 1993, with an effective date of November 1, 1993.

    - Verizon took the restructuring of the price cap baskets into account when it set its special access rates in the 1993 Annual Access Tariff filing, including the headroom that would result from the creation of the Trunking basket. These rates were in effect from December 31, 1993, through June 30, 1994 — that is, for half of the 1993/1994 tariff period.

        - AT&T is thus wrong in claiming that the rates were effective for only one-third of the tariff period. *See* AT&T Ex Parte, OPEB at 5.

        - This also explains why, as AT&T notes, Verizon's rates did not change when the basket restructuring formally occurred in March 1994 — Verizon had already taken the impending change to the price cap baskets into account. *See id.*

    - Therefore, in calculating the headroom for the Special Access/Trunking basket, it is appropriate, as Verizon has done, to calculate the headroom available for the entire tariff period by calculating the headroom available at the start and the end of the tariff period.

        - Contrary to AT&T's claim, this method of calculating the available headroom is proper. *See id.* at 4. In fact, it is the same methodology AT&T used to calculate Verizon's headroom for other price cap baskets. *See* AT&T Aug. 19, 2003 Ex Parte at 3 & Attach. And, due to the unique situation created by the implementation of the Local Transport Restructure in the middle of the tariff period, headroom should be based on the total headroom in the combined basket for that period.

        - AT&T's claim that Verizon should get no credit for any of the headroom in the Trunking basket is contrary to this Commission's clear determination that "[t]here is no basis for 'refunding' . . . amounts [that] were never paid" because the carrier's rates were within the ceiling established by the PCIs. 12 FCC Rcd 8396, ¶ 11. As Verizon has explained, it set the rates that were in effect for the second half of the tariff period based on the headroom that would be available in the Trunking basket.